No. 2791.

United States
Circuit Court of Appeals,
For the Ninth Circuit

THE EQUITABLE TRUST COMPANY OF NEW YORK, as sole TRUSTEE under a Deed of Trust made by the Great Shoshone and Twin Falls Water Power Company, dated May 1, 1910, and Supplemental Mortgages dated June 21, 1911, and April 7, 1913,
Appellant,

vs.

GREAT SHOSHONE AND TWIN FALLS WATER POWER COMPANY, a corporation, WILLIAM T. WALLACE as Receiver of Great Shoshone and Twin Falls Water Power Company, GUY I. TOWLE, and CARL J. HAHN, as Administrator of the Estate of Harry M. King, deceased, Defendants, and L. M. PLUMER and E. B. SCULL, Executors of the Estate of L. L. McClelland, deceased, JAKE M. SHANK, and AMERICAN WATER WORKS AND ELECTRIC COMPANY, a corporation, Interveners,
Appellees.

AMERICAN WATER WORKS AND ELECTRIC COMPANY, a corporation, Intervener, *Appellant,*

vs.

GUY I. TOWLE, CARL J. HAHN, as Administrator of the Estate of Harry M. King, deceased, GREAT SHOSHONE AND TWIN FALLS WATER POWER COMPANY, a corporation, and WILLIAM T. WALLACE, as Receiver of Great Shoshone and Twin Falls Water Power Company, Defendants, L. M. PLUMER and E. B. SCULL, Executors of the Estate of L. L. McClelland, deceased, and JAKE M. SHANK, Interveners, and THE EQUITABLE TRUST COMPANY OF NEW YORK, as sole Trustee under a Deed of Trust made by the Great Shoshone and Twin Falls Water Power Company, dated May 1, 1910, and Supplemental Mortgages dated June 21, 1911, and April 7, 1913,
Appellees.

REPLY BRIEF

Upon Appeal from the United States District Court for the District of Idaho, Southern Division.

MURRAY, PRENTICE & HOWLAND,
Residence: New York, N. Y.
RICHARDS & HAGA,
J. L. EBERLE,
Residence: Boise, Idaho.
Solicitors for The Equitable Trust Company of New York.

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Upon Appeal from United States District Court for the District of Idaho, Southern Division.

Upon the conclusion of the oral argument, leave was granted the appellants to file a reply brief, after the appellee, Jake M. Shank, had submitted the additional authorities and filed the supplemental brief which said appellee was given permission to file.

Appellees Have Erroneously Applied Principles Applicable Only to Judgment Creditors' Suits.

Appellees have fallen into the fatal error of attempting to sustain their position by the application of principles and the citation of authorities limited exclusively to *judgment creditors' suits*, and it would seem unnecessary to do more in this reply brief than to review briefly the vast difference between judgment creditors' suits and a general creditors' suit such as the suit of Guy I. Towle against Great Shoshone and Twin Falls Water Power Company, brought by appellee Towle on behalf of himself and all other creditors, secured and unsecured, and in which the Court appointed a receiver for the benefit of all creditors, to the end that all the assets of the debtor might be conserved and administered for the equal and pro rata benefit of all having an interest in the assets.

The Court in appointing the receiver followed the usual custom of enjoining all creditors and all other persons "from interfering with, attaching, levying upon, seizing, or in any manner whatsoever disturbing any portion of the properties, rights and franchises of the defendant, or taking possession thereof, or in any manner interfering with the same, or any part thereof, without the consent of the Receiver, and from interfering in any manner with or preventing the discharge by said Receiver of his duties or his operation and management of said property and premises under the order of this Court" (Rec. 172), to the end that the assets of the debtor

might be administered and distributed to the creditors according to their respective rights and priorities as they existed at the time of the appointment of the Receiver.

We submit that it is fundamental that where the purpose and object of a suit is for the appointment of a chancery receiver to marshal the assets and hold and manage the same for the preservation and protection of all creditors and of every interest therein, no one creditor or class can, by virtue of the appointment of such receiver, acquire a right to defeat any other creditor or class unless such right existed prior to the appointment of the receiver.

(See authorities cited, p. 20 and pp. 78-87 of this appellant's original brief.)

The only answer that appellees can make to this proposition is to quote from and cite authorities relating to judgment creditors' suits, to the effect that courts of equity have in proper proceedings for such purpose aided such creditors in enforcing their judgments where the remedy at law was clearly inadequate. Appellees have failed to cite a single authority sustaining their contention that after the Court has appointed a receiver in a general creditors' suit and taken jurisdiction and possession of all the assets, it will entertain what they say corresponds to a judgment creditors' suit on behalf of a few of the creditors who previously had no preference, and take from the receiver sufficient of the assets to pay such creditors in full. This proposition is both anomalous and unheard of; it is, if anything, even more unsound

than the "Right of Discovery" upon which appellees sometimes rest their claim to the fund in controversy.

As stated before, this erroneous conclusion is reached by applying to this suit the principles which have always been limited in their application to judgment creditors' suits. Relief in such cases is afforded the judgment creditor in aid of an inadequate remedy at law. The authorities on the subject are fully discussed in the notes to Ziska v. Ziska, 23 L. R. A. (N. S.) 1. On page 7 the annotator says:

> "There are two classes of cases in which a judgment creditor is permitted to come into a court of equity for relief. First, in aid of his execution at law, as to set aside an encumbrance or a transfer of property made in fraud of creditors. The issuing and levy of the execution gives the complainant a lien upon the property, but he is compelled to come into a court of equity for the purpose of removing some obstruction fraudulently interposed to prevent a sale on execution. In this class of cases he may come into court immediately after he has obtained a lien by the levy of his execution, and, the obstruction being removed, he may proceed to the sale of the property under his execution, and subject the proceeds thereof to the payment of his debt. Second, to have his judgment paid out of choses in action, or other property of the debtor which cannot be reached by execution at law. Relief is given in these two classes of cases on different principles —in the first class on the ground of fraud, in the second on the ground that the complainant has exhausted his remedy at law and that it is

inequitable and unjust for the debtor, under such circumstances, to refuse to apply any choses in action, or other property belonging to him which cannot be reached by execution at law, in payment of the judgment."

Clearly, appellees are not judgment creditors, and if they were, the Court could not do the inconsistent thing of first taking possession of all the property in a general creditors' suit and then become active on behalf of a few of the creditors and in their behalf undo what it had undertaken to do in the general creditors' suit in behalf of all.

Typical of the cases cited by appellees is the case of Freedman's Savings & Trust Co. v. Earle, 110 U. S. 710, 28 L. ed. 301, quoted from at length on page 11 of Shank's brief, and from which counsel read to the Court during the oral argument. In that case it appeared that on June 1, 1877, one Dodge conveyed his property in trust as security for certain promissory notes; that on January 4, 1878, the appellee Earle obtained a judgment against Dodge on which a *fi. fa.* was issued April 9, 1879, and returned *nulla bona.* On April 10, 1879, the appellee Earle filed his bill in equity against Dodge and the trustees under the trust deed, the object and prayer of which were to take an account of the debt secured by the trust deed and, subject thereto, to have the premises sold and the proceeds of the sale applied to the satisfaction of the appellee's judgment. A decree was entered on June 11, 1879, in accordance with the prayer of the bill. On December 27, 1879, the appellants filed a petition in the cause, setting

forth the recovery of a judgment in their favor against Dodge on February 11, 1879, and praying that they be made parties complainant in the cause, and that the real estate which had been conveyed in trust, as aforesaid, be subjected to the satisfaction of their judgment; that the same be sold, and the proceeds of sale brought into court and distributed according to law. The sole question was whether the proceeds of the sale should be applied first to the satisfaction of the prior judgment of Earle who had filed the original suit and first sought the aid of equity for the enforcement of his judgment, or whether the proceeds should be applied pro rata between Earle who held the first judgment and the appellants who had acquired a subsequent judgment and who were allowed to intervene in the suit some six months after a decree had been entered in favor of the appellee Earle. The Court, after reviewing the authorities bearing upon the rights of courts of equity to aid judgment creditors in the enforcement of their judgments where the legal remedy was insufficient, says:

> "It is to be noted, therefore, that the proceeding is one instituted by the judgment creditor for his own interest alone, unless he elects to file the bill also for others in a like situation, with whom he chooses to make common cause; and as no special lien arises by virtue of the judgment and execution alone, the right to obtain satisfaction out of the specific property sought to be subjected to sale for that purpose, *dates from the filing of the bill.*" (Our italics.)

In that case the property was not in the custody of the Court in a general creditors' suit to be administered for the benefit of all creditors, and the Court simply applied the rule that the appellee Earle having a prior judgment and having first filed his bill seeking the aid of the Court for the enforcement thereof and obtained his decree on June 11, 1879, and the appellants not having filed their bill seeking the aid of the Court for the enforcement of their judgments until December 27, 1879, Earle had the same priority in equity that he would have had in law, had his legal remedy for the enforcement of his judgment been adequate. The appellee had acquired a prior right and the lien of his judgment was held to date from the filing of his bill, which is undoubtedly the correct rule in judgment creditors' suits. But the purpose of such a suit is the very opposite of a general creditors' suit.

Could it be contended for a moment that after the Court had taken possession of the property in the Towle suit, it could also entertain a judgment creditors' suit to subject all or part of the property in the possession of the Receiver to the satisfaction of a claim of a judgment creditor who could not enforce his judgment by the usual remedies at law? To ask the question is to answer it. Yet in the case at bar that is really what was done, although the appellees are not even judgment creditors. Besides, they had intervened in the general creditors' suit and sought the aid and benefit of that suit, and it is by virtue of rights acquired in that suit that they were permitted

to intervene in the foreclosure suit and contest the mortgage.

As stated above, the situation is most anomalous, and we respectfully submit it is without either precedent or authority and is directly contrary to principles so fundamental and so well established that we shall not attempt to review further the cases cited by appellees on this point.

It seems clear, therefore, that the appellees could not be permitted to intervene in the foreclosure suit and acquire rights in that suit superior to the Receiver or antagonistic to the rights of other creditors. Yet that is exactly what the trial court held that the appellees did do and could do, for it held that the Receiver could not make the defense on behalf of all the creditors which these few favored creditors were permitted to make in their own behalf. It is equally clear that it was by virtue of the receivership proceedings that appellees had acquired the superior equities or status that enabled them, in the opinion of the Trial Court, to attack the mortgage and to acquire for their own exclusive use property which, if not subject to the mortgage, should have been turned over to the Receiver for the benefit of all creditors; and this is undoubtedly the only basis on which appellees feel their position can be sustained, for in their original brief (p. 55) they say: "There can be no real doubt in any fair mind but that a creditor who has had his claim allowed and approved in receivership or insolvency proceedings has the equivalent of a judgment." Having obtained the allowance of their claims in the receivership proceed-

ings, appellees' position, therefore, is that they have the equivalent of a judgment and that they might therefore invoke the aid of the Court, as in the case of a judgment creditors' suit, to secure for themselves, in satisfaction of their alleged judgment, the property of which the Court had taken possession for the benefit of all creditors.

Appellees Could Not Intervene as General Creditors.

It is true that appellees at times appear to argue that they had the right to attack the mortgage wholly independent of the receivership proceedings and as mere unsecured general creditors, but on that point the authorities cited in our original brief (pp. 17, 18, 54, et seq.) are conclusive, and as that point has been decided squarely against appellees by the Supreme Court of the State, that construction will be followed by the Federal Courts.

To meet this situation appellees cite the case of Union Trust & Sav. Bank v. Idaho Smelter and Refining Co., 24 Ida. 735, but that was a case where a creditor as assignee of certain judgments sought to intervene in a foreclosure suit for the purpose of defeating the mortgage by showing that the bonds alleged to be outstanding had been fraudulently and illegally issued and that there was therefore no indebtedness, and hence the property should not be taken by the mortgagee under foreclosure. The contest there was not over the mortgage but whether the indebtedness was fraudulent and illegal because the mortgagor had violated certain constitutional and statutory provisions in issuing bonds or creating

an indebtedness in a manner prohibited by law. We think there can be no question but that creditors in the case of an insolvent company may be permitted to show that the indebtedness for the satisfaction of which the property is about to be sold is fraudulent and fictitious. Clearly, in such cases a court of equity could afford appropriate relief where the debtor himself is a party to the fraud and fails to set up available defenses, but the rule which would apply in such cases can have no application here. Appellees have never questioned the validity or the amount of the indebtedness secured by this appellant's mortgage. The complaints in intervention or answers of the appellees admit that this appellant is entitled to a judgment for the amount of its outstanding bonds and accrued interest, and the contest was solely upon the point as to whether it could foreclose upon certain personal property in view of the failure to file the mortgage as a mortgage on personal property and in view of the omission of the affidavit required in such cases. But under the statutes of Idaho and the decisions of its highest Court, the mortgage was valid as between the parties and it could not be contested except by someone who had an interest in the property by lien or attachment. (See pp. 59-60, this appellant's original brief.)

Right of Appellees to Intervene May Be Questioned on Appeal.

The appellee Shank in his brief contends that the motion to dismiss the complaint in intervention and to vacate the order permitting said appellee to inter-

vene and to strike what is denominated the answer of said appellees, is too general, and that the order overruling such motion is not subject to review. We think a sufficient answer to that contention is a reading of the motion (Rec. pp. 139-140). Among other things, the motion states: "That the said petition is wholly insufficient in law and equity, and does not set forth facts sufficient to entitle said petitioner to intervene or be made a party defendant in said cause", and that the answer should be stricken from the files "for the reason that it appears therefrom that said intervener has not such interest in this litigation as to enable him to intervene or be made a party defendant in said cause, and the matter set forth in said alleged answer does not constitute a proper defense to complainant's bill of foreclosure, and the allegations therein contained do not set forth matters sufficient to disentitle complainant to the relief sought in the bill." The order overruling the motion was deemed excepted to and no reply was necessary to the answer for the new or affirmative matter set forth therein was deemed denied under equity rule No. 31.

But if it be held that the Court did not err in permitting appellees to intervene, the question still remains whether they had such interest in the property as to entitle them under the laws of the State of Idaho to contest this appellant's mortgage, and if so, whether the proceeds from the property thus obtained from under the mortgage should be devoted to the payment of appellees' claims in full, or whether they

should be turned over to the Receiver for disbursement in the general creditors' suit according to the principles governing the distribution of assets in such cases.

Appellant Is Entitled to Appeal Before a Deficiency Judgment Is Entered.

It is also contended by appellees that a deficiency judgment has not yet been entered in favor of appellant, and that therefore it cannot object to the erroneous decree, or to the errors of the Court committed during the trial. We know of no rule that prohibits a mortgagee from seeking a review of the errors committed against it in the trial of the foreclosure suit and of the errors which appear in the decree, until after it has enforced the decree and obtained a deficiency.

In the case at bar, by stipulation and orders of the Court, it was practicable to proceed with the enforcement of the decree before the appeal was determined, for the errors complained of were of such a character that a modification of the decree on appeal could be as effectively applied to the proceeds of sale as to the property before sale, and it was therefore to the interest of all parties to terminate the receivership as early as possible, sell the property, and wage the contest over the division of the proceeds.

The proposition that appellant might not be entitled to judgment for the face of the outstanding bonds with interest, was advanced by the Court and not by appellees, but in order not to delay the sale of the property and the termination of the receiver-

ship, the decree provided (Rec. p. 208) "that the Court reserves jurisdiction and power to hereafter determine the amount due from the Power Company to the several holders of said bonds and coupons," and also (Rec. p. 209) "that in case there shall be any deficiency in the amount required to be paid in full of the several amounts directed and allowed to be paid, then the Special Master shall report to the Court the amount of the deficiency." In the order confirming the sale (Rec. p. 223) it is provided that: "The Court further retains jurisdiction of the cause for the purpose of determining the amount of the deficiency, if any, to which complainant may be entitled."

This appellant in its assignment of errors raised the point that the Court should have entered a decree on the record before it for the full amount of bonds outstanding and accrued interest thereon, and that there was no occasion for taking further proof on that point; but in order to shorten the record on appeal and secure a speedy settlement of the statement so that the cause might be heard at this session of the Circuit Court of Appeals, appellant waived its assignment of error on this point.

There is not the slightest basis for the contention of appellees that appellant has waived its right to a deficiency. The reservations made by the Court in the decree and order of confirmation show conclusively that there has been no such waiver, and while judgment must eventually be entered for the full amount of the bonds outstanding—$2,230,000, with

interest from May 1, 1914, thus leaving a deficiency of several hundred thousand dollars, as the property was sold for two million dollars, from which must be deducted $45,000, the value of the personal property which the Court held was not subject to the mortgage, and the costs and disbursements of the Trustee and the fees of the Trustee and its counsel. But if for any reason it should be held that judgment should only be for the notes issued, viz., $1,780,000, and for the $5,000 of bonds which had been sold to the public without first being pledged as security for the notes, and accrued interest, the amount due would still be in excess of the available proceeds, so in any event there would be a substantial deficiency.

If This Appellant Is Not Entitled to Deficiency Then Appeal of American Water Works and Electric Company Must Be Sustained.

The fallacy of appellees' position most clearly appears in connection with their argument as to the deficiency judgment. The Trial Court denied the American Water Works and Electric Company the right to intervene, for the reason that the money which was ordered paid to appellees was taken from the mortgagee—this appellant—and not from the creditors, and that has always been the contention of appellees as to why they should not be required to pro rate with other creditors. They have plausibly argued that they took nothing from other creditors but that what will be paid them would be taken from the mortgagee. The fallacy of this position is clearly brought out in their contention that the mortgagee

has been paid in full out of the balance of the property. If that be the case, then clearly the $45,000, realized from the sale of the personal property which the Court held was not subject to the mortgage, would be surplus which the Special Master should pay to the mortgagor or its Receiver for disbursement in the general creditors' suit among all the creditors. Hence, if appellees contend that there is and can be no deficiency because this appellant has been paid in full, then the appeals of the American Water Works and Electric Company and other creditors must necessarily be sustained, for they will clearly be deprived of their pro rata share of the surplus from the sale of the mortgaged assets of the insolvent debtor.

Relation of Appellants to Each Other Does Not Affect the Rights of Appellees.

The contention of this appellant that its mortgage is a lien upon all the personal property, is necessarily adverse to the contention of the other appellants, but if for any reason the Court should conclude that the Receiver or the appellees were entitled to contest the lien of this appellant's mortgage as to such personal property, then we submit that we are entitled to share, to the extent of our deficiency, pro rata with all other creditors of the Power Company, and to that extent we are in entire accord with the appeals of the American Water Works and Electric Company and other creditors. But we deem it wholly unnecessary to reply to the unwarranted and gratuitous charges of collusion contained in the briefs of appellees. The

record does not furnish the slightest foundation for such statements.

It is true that the owners of the first mortgage bonds as part of the plan of re-organization have lately negotiated for the purchase of the claims of the American Water Works and Electric Company, but surely that cannot destroy or change the legal status of the claims. It cannot be that the unsecured claim of the American Water Works and Electric Company should be paid if owned by one party and repudiated if owned by another.

Much has been said in appellees' briefs about the circumstance that H. Hobart Porter, president of the Power Company, telegraphed from his office in New York to counsel for the Power Company at Boise regarding the appearance and the filing of an answer by that Company in the foreclosure suit. The reason for doing so is apparent. It was to the interest of all creditors and the Power Company that the proceedings in the case should be regular, to the end that the property might be sold under an assurance of good title passing to the purchaser under the sale, and up to that time the Power Company had simply entered an appearance in the case without filing its answer, and counsel for the Company was not present at the trial. Believing that possible objections might be raised to the title under such circumstances and that there might be delays and complications resulting from the necessity of taking a decree *pro confesso* as against the Power Company, the president of that Company upon being advised by complainant that the Power Company was doing itself

as well as its creditors an injustice by not appearing at the trial, advised the solicitor for the Company to appear in the case, and as the Company concededly had no defense whatever to the mortgage or the suit for foreclosure, it did the honorable and only thing which it could consistently do, viz., it filed an answer admitting the allegations of the complaint, as it had previously done in the general creditors' suit brought by Guy I. Towle. It should be noted also that this telegram was sent by the president from New York on Tuesday, October 26th, when he could not have had any knowledge or information of the interventions which had been permitted the preceding day on behalf of Shank and on late Saturday afternoon on behalf of Plumer, Scull and Towle.

The fact that Mr. Porter is also president of the American Water Works and Electric Company can be of no importance, for manifestly that Company cannot be charged with notice of what is done by the Power Company or by Mr. Porter as president of that Company. That the American Water Works and Electric Company knew that the mortgage of complainant was being foreclosed is admitted, but there is not the slightest foundation for the charge on the part of appellees that it also knew of their intervention or of the provisions of the decree relative to the payment of the claims of appellees in full, until after the decree had been entered. On that point it would seem that the statements in the verified petition to intervene must be accepted as true until overcome by proper evidence on a hearing for such

purpose. The statements of appellees to the contrary are apparently as well founded as the repeated statements that all other creditors of the Power Company were satisfied with the decree and its provisions for the distribution of the Unsecured Creditors' Fund, whereas a number of other creditors—Thousand Springs Power Company, Intermountain Electric Company, Guaranty Trust Company of New York and American Water Works and Electric Company —had tried in vain to get the Receiver to appeal and to get the Trial Court to allow an appeal on behalf of the Receiver so that the rights of all creditors might be protected, and it became necessary for such creditors to apply to this Court for the allowance of their appeal in order that their rights might be saved and protected before the time for appeal expired.

This appellant refers to these matters simply to the end that the Court may not be misled by statements and charges in the briefs of counsel not supported by the record and to the end that the case may be disposed of on its merits and each creditor receive what he is entitled to under the law and the principles of equity governing the administration of assets of insolvent debtors.

Respectfully submitted,

RICHARDS & HAGA, and

J. L. EBERLE,

Solicitors for Appellant, Equitable Trust Company of New York, Trustee.

Residence: Boise, Idaho.